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No. [redacted].95 OCTOBER TERM, 1931.

IN THE

Supreme Court of the United States

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, Petitioner,

v.

COMMONWEALTH IMPROVEMENT COMPANY, Respondent.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

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In the Supreme Court of the United States.

OCTOBER TERM, 1931. No. .

David Burnet, Commissioner of Internal Revenue, Petitioner,

v.

Commonwealth Improvement Company, Respondent.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI.

COUNTER-STATEMENT OF QUESTION PRESENTED.

Whether a Court is obliged to hold that an apparent profit resulting from a transaction between a corporation and its sole stockholder

is a taxable gain under Section 202 of the Revenue Act of 1918 because the corporation and the stockholder are separate entities in law, or whether that Court has discretion to examine the facts and circumstances of the particular transaction to determine if a gain in substance has been realized or a gain in form only.

ARGUMENT.

We respectfully submit that the petition for writ of certiorari should be denied. The decision of the Circuit Court of Appeals in this case (1) is not in conflict with decisions of other Circuit Courts, nor can the decision (2) be of "great general importance in administering the income tax laws" (Petition, 5) because it is purely a fact decision which, by its very language, is applicable only to the particular facts in issue. These two statements specifically controvert the two reasons advanced by the learned Solicitor General (Petition, 4, 5) for granting this writ.

The Solicitor General errs in stating that the decision of the Circuit Court of Appeals is in conflict with cited decisions of the Circuit Court of Appeals for the Second Circuit, for the Fifth Circuit, and for the District of Columbia, in that, in his view, the decision in the instant case stands

for the general proposition that where an individual or an estate owns all the stock of a corporation, the separate entity of the corporation should be disregarded for Federal tax purposes. The decision in the instant case does not so hold, but on the contrary it is based solely upon a principle long recognized by this Court in tax cases, to wit, that the substance of a transaction rather than its form must prevail. The accuracy of our statement cannot be more clearly demonstrated than by quoting from the opinion of the Circuit Court of Appeals in the instant case (R. 53, 54):—

> **"The taxpayer, itself, concedes that it and the estate are distinct beings in contemplation of the law and subject to the burdens thereof. But the taxpayer asks this court to deny the Government's right to tax gains, profits, or income that are illusory, and do not exist in fact.**
>
> **"By determining whether this court has the power to examine this exchange of property for its substance, we come to the ultimate questions in this case: (a) Is there any real gain or loss to be taxed? and (b) did Congress intend to tax that which is income in form only?**
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> **"Counsel for the taxpayer have offered two cases, which they frankly admit do not control this case on its facts, to show that we may**

examine the transaction here concerned for its substance as an incidence to income taxation. Southern Pacific Company v. Lowe, 247 U. S. 330; Gulf Oil Corporation v. Llewellyn, 248 U. S. 71."

* * * * * * *

"The point comes down to this: Did Congress intend that 'income' should be used as a word of art or in a real and practical sense?"

We submit that the whole opinion of the Circuit Court of Appeals in the instant case, and in particular those portions which we have quoted above, make it clear that the Court did not view the *Southern Pacific* and the *Gulf Oil* cases as precedents for the general proposition that separate entities of individual and corporation are to be disregarded in tax cases, but that the Court viewed these two decisions simply as giving it *discretion* to examine a transaction in issue to ascertain whether or not that particular transaction produced income in fact as contrasted with income in form only. Disregard of the corporate entity of the taxpayer, if it can be said to have been disregarded, was only an incident in the result. This being so, it is plain that the decision in the instant case cannot conflict with decisions of other Circuits which may have held that, under other facts, such entities were of the essence of the particular transactions or

situations and so determinative of actual profit or loss.

It necessarily follows that the instant case cannot be of "great general importance in administering the income tax laws," as is stated by the learned Solicitor General, and that in fact the only interest of the Government in this case is the amount of tax specifically in issue. As indicated by the opinion of the Circuit Court of Appeals, the primary question was whether in this case the particular transaction resulted in such a profit as was taxable under the general principles of *Eisner* v. *Macomber,* 252 U. S. 189. That being so, the decision is purely a factual decision. We submit that the whole opinion of the Circuit Court of Appeals not only demonstrates the correctness of our statement in this respect, but that the Court took particular pains in certain portions of its opinion to make this point so clear that no one could thereafter attempt to use its decision as a precedent for the proposition as to which the learned Solicitor General is apprehensive. For example, we quote from the opinion (R. 52, 53, 55) as follows:—

> **"This petition for review concerns income and excess profits taxes for the year 1920. The extraordinary situation here arises out of the relation of the taxpayer to the estate of P. A. B. Widener."**
>
> * * * * * * *

"And, thus, came about the unusual situation which brings us to the issue in this case."

* * * * * * *

"The profit resulting to the taxpayer is illusory and non-existent. The law is interested in an income from which an economic benefit may be realized."

We respectfully submit that these quoted portions from the opinion, particularly when read with the whole opinion, very definitely limit the decision to the particular facts before the Court below.

As we have said, and as that Court specifically stated in its opinion, the primary question in the instant case was *not* whether the separate entity of a corporation (Commonwealth Improvement Company) should be disregarded, but whether, on the particular facts, a profit in substance was realized. The Court below discusses these facts at length in its opinion, but they may be very briefly summarized by saying that in 1912 Mr. Widener desired to place a lien on his fortune to insure an endowment for a charity, The Widener Memorial School for Crippled Children, and that he did so by transferring the bulk of his fortune to the taxpayer, the Commonwealth Improvement Company (R. 17, 18). The taxpayer then issued its debentures and other securities to Mr.

Widener, who in turn placed a portion of the debentures in trust for the charity (R. 17, 18). In 1920, after Mr. Widener's death, it was deemed advisable by his Trustees to substitute certain real estate bonds owned by the Widener Estate as endowment for the charity in lieu of the debentures (R. 19). At this time part of the Widener Estate was administered directly by the Trustees and part by the Trustees through the taxpayer, the Trustees and their counsel being its officers, directors and sole stockholders (R. 18). The substitution of bonds for debentures was accomplished by the Trustees of the Estate delivering the bonds to the charity in exchange for the taxpayer's debentures (R. 19). The Trustees then transferred the debentures and certain other securities to the taxpayer in exchange for a block of stock of substantially greater market value, the transaction being balanced by a bookkeeping credit in favor of the taxpayer (R. 20). The debentures were cancelled, so that the net result to the Widener Estate as an entity was that it had received back from the charity obligations of the taxpayer of a face value of $4,000,000, and had given to the charity real estate bonds of a like face value (R. 19, 20). The subsidiary transfer between the Trustees of the Widener Estate and the incorporated portion of the Estate, to wit, the taxpayer, was balanced by book entries as

was the custom when it seemed desirable to shift funds or securities from one hand to the other (R. 19), and did not add or subtract one penny from the net worth of the Estate or the taxpayer. This point was made clear by the Circuit Court of Appeals in the following quotation from its opinion (R. 55):—

> **"Obviously, in actual dollars and cents, it made no difference to the estate, itself, whether or not they obtained anything in return; but, in order to balance the books, the block of British-American Tobacco stock was taken, as its then value was substantially the same as on March 1, 1913, and was the largest single block standing in the taxpayer's name.**
>
> **"The stock was transferred, and to offset the balance due the taxpayer on the exchange, it was given credit on its books. The result of the transaction produced no gain, nor loss, nor income to either the taxpayer or the Widener estate."**

It will be noted that the taxpayer was never more than a holding company (R. 17, 18, 19, 20) and was never engaged in separate business ventures as were the corporations in the *Nixon, Wagner, Goldberg* and *Planter's Cotton Oil* cases cited by the Solicitor General on pp. 8 to 11 of his Brief. Furthermore, that at the time the

transaction was effected in 1920 there was not even a bookkeeping profit to the taxpayer, but that subsequently the regulations of the Treasury Department were changed by Treasury Decision 3402 approved October 18, 1922, following the decision of this Court in *Miles* v. *Safe Deposit Company,* 259 U. S. 247, with the result that a taxable profit on paper was created of approximately $1,000,000. It is this paper profit which the Circuit Court of Appeals held to be a profit in form and not in substance.

The learned Solicitor General argues on page 11 of his Brief that we should not be permitted now to deny the separate character of the taxpayer and the Widener Estate because (1) the taxpayer in its return for 1920 claimed a loss resulting in part from the particular transaction; (2) the taxpayer has paid its taxes at corporate rather than individual or estate rates; and (3) the transfer by Mr. Widener to the taxpayer of his non-Pennsylvania stocks resulted in the avoidance of estate taxes outside of Pennsylvania. We reply that there can be no estoppel against the taxpayer on any of these grounds, but beyond this, that they do not serve to shift the equities from the taxpayer to the petitioner.

As to the first point, it is sufficient to say that taxpayer's return for 1920 was filed to conform with its books of account, and that the loss

claimed was purely nominal and without result on tax liability because its disallowance resulted only in reducing the amount of the taxpayer's loss for the year (R. 10, 11). Furthermore, we offered to prove at the trial of this case that the Commissioner of Internal Revenue settled taxpayer's returns for prior years on the basis that a comparatively small apparent profit to the taxpayer in 1917 and a comparatively small apparent loss to the Widener Estate in 1919, both of which resulted from transactions between the taxpayer and the estate, were to be disregarded because of the identity of the two (R. 45, 46, 47). The refusal of the Board of Tax Appeals to receive such proofs was assigned as error in our Petition for Review to the Circuit Court of Appeals (R. 30, 31).

As to the second point, that the taxpayer has benefited by paying its taxes at corporate rates, we suggest that it has always been open to the Government to correct any abuse in this respect as between the taxpayer and its sole stockholder, the Widener Estate, by invoking the provisions of Section 220 of the Revenue Act of 1918 (see Appendix) or like provisions of other Revenue Acts.

As to the third point, that the Widener Estate benefited because its use of the taxpayer avoided

estate taxes on Mr. Widener's death to other sovereignties than Pennsylvania, we need only point out that when Mr. Widener died there was no Federal Estate Tax, and that as Pennsylvania was his domicile, the result accomplished was the result approved by this Court in *First National Bank of Boston* v. *Maine,* 284 U. S. 312.

Finally, we submit that such portion of the petitioner's brief as is devoted to an apparent conflict between the decision in the instant case and that of the Court of Appeals of the District of Columbia in *Ayer* v. *Blair,* 25 Fed. (2d Ed.) 534, may be disregarded. That case dealt with the validity of Article 39, as amended, of Treasury Regulations 45, and as stated by the learned Solicitor General (Petition, 3, 4). The Court below found it unnecessary to pass upon this question inasmuch as it disposed of the case upon the larger question, to wit, whether or not income in fact had been realized.

CONCLUSION.

We therefore respectfully submit, in conclusion, that the petition for writ of certiorari should be denied because the decision of the Court below is not in conflict with the decisions of any other Circuit Court of Appeals, but is purely a factual

decision; that the Court found its authority for examination of the facts under a long recognized principle, to wit, that in questions of income taxation the substance and not the form must prevail; and that under these circumstances the decision of the Court below cannot be of any great general importance in administering the tax laws, but can only be of importance to the Government with respect to the specific amount of tax involved.

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APPENDIX.

Revenue Act of 1918, c. 18, 40 Stat. 1057, Section 220.

SEC. 220. That if any corporation, however created or organized, is formed or availed of for the purpose of preventing the imposition of the surtax upon its stockholders or members through the medium of permitting its gains and profits to accumulate instead of being divided or distributed, such corporation shall not be subject to the tax imposed by section 230, but the stockholders or members thereof shall be subject to taxation under this title in the same manner as provided in subdivision (e) of Section 218 in the case of stockholders of a personal service corporation, except that the tax imposed by Title III shall be deducted from the net income of the corporation before the computation of the proportionate share of each stockholder or member. The fact that any corporation is a mere holding company or that the gains and profits are permitted to accumulate beyond the reasonable needs of the business, shall be *prima facie* evidence of a purpose to escape the surtax; but the fact that the gains and profits are in any case permitted to accumulate and become surplus shall not be construed as evidence of a purpose to escape the tax in such case

unless the Commissioner certifies that in his opinion such accumulation is unreasonable for the purposes of the business. When requested by the Commissioner, or any collector, every corporation shall forward to him a correct statement of such gains and profits and the names and addresses of the individuals or shareholders who would be entitled to the same if divided or distributed, and of the amounts that would be payable to each.